



DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

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Contact Michele Davis at 202-622-2920.

U.S. LEADERSHIP IN THE GLOBAL ECONOMY

TESTIMONY OF TREASURY SECRETARY PAUL H. O'NEILL BEFORE THE COMMITTEE ON FINANCIAL SERVICES OF THE HOUSE OF REPRESENTATIVES FEBRUARY 28, 2002, 1:00 P.M.

I. Introduction

Chairman Oxley, Representative LaFalce and Members of the Committee, thank you for inviting me here today to discuss President Bush's international economic agenda and our efforts at the Treasury Department to advance that agenda.

Mr. Chairman, when I accepted the job of Secretary of the Treasury, President Bush directed me to meet a number of important challenges. One of those challenges – one I take very seriously and personally – is our nation's role in international economic growth and development. The President's message to me was very clear: if we care, and we have simple respect for human dignity, then we must finally begin to deliver on a half-century of unfulfilled promises to raise the standard of living of poor people living – and dying – in the world today. President Bush feels that U.S. leadership is essential to meet this challenge and I agree with him. The United States should be a locomotive of global economic growth and a champion of economic development in those parts of the world that have lagged behind.

Let me be clear: the creation of economic growth and jobs in the U.S. economy is our overriding concern. In fact, I believe that getting our economic policies right at home is one of the best contributions we can make to global economic growth.

It is also true that growth and prosperity in the global economy are vital interests of the United States because economic growth is associated with peace, stability, democracy, innovation, and the expansion of markets. These are important national goals. An even more fundamental goal for our nation is to see that the people of the world have the opportunity to live

at their potential. That is a hope each and every one of us holds out for the world, and we have an obligation to do what we can to achieve it.

When the leaders of the free world joined together more than fifty years ago with a commitment to speed the progress of the underdeveloped world, they could not have imagined how slow progress would be. This is especially unsettling since over those same fifty years, we have also witnessed incredible feats of human progress. Countries have risen from the ashes of war to become vibrant, thriving members of the community of nations. People have struggled and succeeded in discarding the yoke of totalitarian regimes to create free democracies. Today, more people than ever before in the history of the world have the opportunity to compete, to reap the benefits of their labor and creativity in free markets, and to create wealth. And the resultant miracles of science, health, and technology are truly inspiring.

So why are so many people still poor? Why have so many people been left behind?

It is not because the people in developing countries aren't capable of all the same advances the rest of the world has created. In my experience running a global enterprise, I saw brilliant ideas put forward by people in every corner of the world. What is lacking in the nations that have failed to progress is a system that supports the deployment of new ideas. Most of the basic building blocks of such a system are relatively inexpensive: good government, good educational systems, the rule of law, respect for property rights, a commitment to free markets, a commitment to peaceful relations with neighboring countries.

But for many countries these foundations for development are beyond their reach – either for lack of money, lack of know-how, or lack of encouragement or incentives to do the right thing. And in some cases, countries have simply been led down the wrong road because of policy prescriptions from the international community and the sometimes perverse incentives our international assistance programs have created.

I believe that we can succeed in effecting change. Let me take a few minutes to discuss some of the ways we are trying to drive change.

II. Strengthening International Economic Cooperation

Achieving economic growth and stability is absolutely fundamental to improving the lives of our citizens and those all around the world. And it is vital to greater security for all of us. With this in mind, we spend an enormous amount of time and effort working with other countries toward these goals.

One of the challenges we face in this task is balancing the need to provide leadership and impetus with the importance of respect and deference to other countries' decision-making processes. As President Bush has said, the United States should not lecture other countries but rather should respect their sovereignty concerning their own policies. Indeed, a fundamental principle of our approach is that other countries should have ownership of their economic policies. Governments need to bear the responsibility for addressing their own economic

problems and challenges – and ensuring that they choose prudent policies that will bring them sustained growth and stability over the medium and long term. We would accomplish little if we tried to force them to follow our wishes, since only lasting and committed implementation of economic policy measures will deliver real results.

This is why, while seeking to deepen and enrich our contacts and cooperation with other countries on economic and financial issues, we avoid pressuring countries to adopt our solutions to their problems. The ongoing dialogue that we maintain with our Group of Seven (G-7) partners has embodied this approach. We value our interactions with our G-7 colleagues. At the same time, we are careful in these sessions to be sensitive to the fact that each country needs to – and should be encouraged to – pursue policies appropriate for its own circumstances.

G-7 meetings provide key opportunities to share information, discuss policy considerations in our own economies and pursue innovative approaches to international policy issues of shared concern. In recent months, we have had concrete discussions with others in the G-7 on how to achieve our common objective of higher global economic growth. We expect to issue a quantitative, fact-based study around the time of the G-8 Heads of State Summit in June that discusses a number of policy changes that could vastly improve global economic growth. The G-7 is also working together on a variety of other issues, including our efforts to rid the world's financial system from terrorist fundraising activities and reform of the international financial institutions.

III. Enhancing Stability and Growth: Reform of the International Monetary Fund

To unleash human economic potential, it is vital that economies have a sound and stable basis on which to grow. Cultivating conditions in the international economic and financial system that support growth is the job of the International Monetary Fund. Indeed, rather than serving as a firefighter for crises, the IMF should become more like a gardener, nurturing the seeds of private sector growth.

The first task is to prevent the eruption of crises that undermine and reverse growth. This is a formidable intellectual challenge, since it is difficult at best to identify trouble far enough ahead so that something can be done to prevent it. And it is equally a leadership challenge, since prevention requires the political will to take decisive and often unpopular steps early in order to avert a crisis that may not yet be apparent to others. Enhancing its crisis prevention role means that the IMF must take a number of steps. It needs to do better in detecting signs of trouble itself, and with our encouragement the IMF is taking steps to strengthen its internal early warning systems. Greater transparency is also fundamental, both on the part of the IMF and its member countries, so that financial markets can discern the true performance and potential risks of individual economies and the system as a whole. When countries publish timely data on their performance, markets can make informed decisions – and this is indeed happening now, with forty-nine countries complying with the new standards for data disclosure. For its part, in addition to being more transparent about its operations, the IMF needs to speak out when it sees trouble looming. It is up to countries themselves to make policy changes to avoid crises, but the IMF must make itself more vocal in identifying problems as they develop.

I want to touch briefly here on contagion. I was criticized last year when I said that contagion was not something that God intended us to have. But I saw that something important was changing in international financial markets, and I thought that it was important to draw attention to it to further drive that change. Fear of contagion can cause the IMF and others to do things that shield investors from the risks of their investments, which only increases the chances that a crisis will recur. In fact, financial markets, aided by greater access to information, are now increasingly differentiating between those countries that are pursuing strong, growth-oriented policies and those that are not. This is an important development.

To be more effective in cultivating growth, the IMF also needs to narrow the focus of its involvement in member economies. In the past, the IMF allowed its activities to expand into areas outside those central to its mission and thus to overlap with the mandates of the multilateral development banks, for instance in promoting agricultural reform and judicial reform. The IMF does not have a comparative advantage in addressing such issues, and attempting to do so arguably diminishes the Fund's effectiveness in pursuing more central objectives. Rather, the Fund should focus on monetary, fiscal, exchange rate and financial sector policies that lay the macroeconomic framework for growth.

The IMF is already making progress in narrowing the focus of its work. New country programs reflect a sharper concentration on key areas and a prioritization of measures necessary for reforms to succeed. This is a welcome change. And a broader review of the conditions attached to IMF lending continues. As part of this review, we are emphasizing the need for the IMF to be selective in providing financial support. The IMF needs, in short, to demonstrate a greater willingness to focus its support on countries doing the most to help themselves, and to decline to finance cases in which a country is not prepared to take the steps required to achieve credible reforms and a sustainable growth path.

One important mechanism for identifying and supporting countries that are truly committed to reform is to make greater use of "prior actions." These are conditions that countries must meet before a program is approved and Fund resources are disbursed. As such, they provide the opportunity for countries to demonstrate their strong commitment and ownership of sound economic policies – and for the IMF to ensure up front that reforms will be implemented. This approach was important to the IMF's support for Turkey in May last year, when Turkey took decisive steps to implement nine key prior actions before the IMF agreed to a new program with increased financing.

But this in itself is not enough to change fundamentally the role of the IMF in the international system. Rather, we need to make clear that there are limits on official support to countries in unsustainable situations – that they will not be "bailed out" despite a history of bad policy choices and a lack of commitment to reform. This is essential to avoid distorting incentives for countries and investors alike. It is up to the IMF and its members to impose such limits. This does not mean that we should set rigid ceilings on the amount of financing that the IMF can provide when a country is adopting a strong reform program. But it does mean reining in the tendency to provide generous financing packages when a country's debt situation is unsustainable and tough-minded reforms are needed.

This brings me to a particularly difficult but critical issue – what to do when a country’s debt situation is unsustainable. Despite several recent incidents, there remains no clear, agreed approach to dealing with such a situation. And the uncertainty that remains simply creates too much pressure for large-scale official lending by the IMF and may contribute to decreased investor willingness to invest in some emerging markets.

To help reduce this uncertainty, we are working with others in the official sector in considering the development of a sovereign debt restructuring mechanism that will provide a more predictable framework for debt workouts. Having such a workout strategy in place may help reduce the pressure for large-scale financing – and it may also create the potential for increased capital flows to emerging markets at lower interest rates. Of course, creating and implementing such a mechanism are not simple tasks. A number of options for the design and implementation of this mechanism are being considered. For our part, the U.S. Treasury is emphasizing the need for a mechanism that is market-based, encourages creditor and debtor ownership of the process, and avoids raising concerns about conflict of interest. One option that fulfills these criteria would encourage borrowers to put certain clauses in their debt documents to help facilitate a more orderly process if a restructuring is necessary. Of course, there are many issues that would need to be considered in implementing such an approach, including how to encourage the use of these clauses in debt contracts. As we proceed, we are consulting with various experts in the private sector, and we look forward to continuing to consult with the Congress as well.

IV. Building Key Bilateral Economic Relationships

Let me spend a few minutes discussing some of our key initiatives in the bilateral area, where we have made a major effort to focus our economic relationships on concrete, measurable goals, with specific timelines for achievement.

Economic Component of the Strategic Framework with Russia

First, Russia. During our meeting with President Putin last summer, Commerce Secretary Evans and I agreed to develop a checklist – a time-bound list of concrete accomplishments that both countries want to achieve in the economic sphere – that would allow the United States and Russia to measure progress on our bilateral economic agenda. In the ensuing months, we worked with President Putin’s economic team to develop a list that includes specific steps to advance Russia’s WTO accession, to help Russia build a business climate to attract private investment, and to further our common goal of fighting money laundering and terrorist finance. Two important items on this checklist relate to the creation of a sound Russian banking system – capital needs to be much more broadly available in Russia to those outside the natural resource-based sectors. First, we have helped launch a U.S.-Russia Banking Dialogue as a vehicle for practical private sector ideas. And, second, we support expanding the EBRD’s Russia Small Business Fund which has been extremely successful in giving small businesses all over Russia access to credit on market terms.

Additionally, it is important to give credit for strong policy reform where credit is due. Following the August 1998 financial crisis, Russia floated its currency and undertook comprehensive tax reform, including the establishment of a flat 13 percent personal income tax and a dramatic overhaul of its tax administration system. Growth has rebounded strongly, averaging over 6 percent a year in 1999-2001. And because of these policy actions, what was a fiscal deficit of 6 percent of GDP in 1998 became a fiscal surplus of 2.5 percent of GDP in 2000. The reduction in the corporate income tax from 35 percent to 24 percent, which went into effect in January 2002, will help support this trend.

U.S.-Mexico Partnership for Prosperity

Second, Mexico. President Bush has said, “The stronger Mexico is, the less pressure on our border; the stronger Mexico is, the more prosperity there will be in both our countries.” And, “Trade with Mexico is an integral part of making sure that our hemisphere is safe, secure and prosperous.” Mexico and the United States share more than just a geographical border. Since signing the North American Free Trade Agreement in 1993, Mexico has become the U.S.’s second largest trading partner and fastest growing export market. Our business cycles are closely aligned, and financial markets increasingly view Mexico’s economy as more closely linked to the U.S. than to Mexico’s Latin American neighbors.

These growing links and the close relationship between President George W. Bush and Mexican President Vicente Fox prompted the leaders to form the U.S.-Mexico Partnership for Prosperity in September 2001. The goal of the Partnership is (i) to unleash the economic potential of every citizen, (ii) to harness the power of open markets and private enterprise in order to spur economic development in Mexico, and (iii) to do so through an authentic Partnership not just between governments, but also between our respective private sectors.

Official flows from the U.S. and the international financial institutions are dwarfed by private flows to Mexico. The Partnership is dedicated to facilitating those private flows, maximizing them, and leveraging them through coordination with other private flows and official flows. Along with top government officials from the U.S. and Mexico, experts from business and academia have come together in a series of roundtable discussions to develop ideas to stimulate investment and growth in Mexico and achieve the goals of the Partnership.

A final report is being drafted jointly with public and private sector participants from both Mexico and the U.S. and will be presented to President Bush and President Fox on March 22 at the UN Financing for Development Conference in Monterrey, Mexico.

Reconstruction of Afghanistan

Finally, Afghanistan. The international donor community is committed to close coordination on reconstruction efforts for Afghanistan. Treasury, working closely with the State Department, initiated efforts to begin the multi-year, multi-billion-dollar process of Afghanistan’s reconstruction. On November 20th 2001 – even before the formation of the Afghan Interim Authority – senior officials of the international donor community came together in Washington, D.C., to begin discussing a structure and process for Afghan reconstruction

assistance. An early accomplishment was the formation of the Afghanistan Reconstruction Steering Group (ARSG), co-chaired by the United States, Japan, EU/EC, and Saudi Arabia. This group's role is to provide political impetus, encourage contributions and provide overall policy guidance to the international economic reconstruction effort. The first ARSG meeting was held in Brussels on December 20-21, 2001.

Since November, the United States has been a leader in catalyzing international donor efforts. Secretary Powell and I led the U.S. delegation to a January 2002 Tokyo meeting of the Steering Group, where donors pledged some \$1.8 billion for Afghan reconstruction efforts in 2002, and a preliminary initial total of \$4.8 billion for the 2002 - 2006 period. Ministers and representatives from 61 countries and 21 international organizations attended. The Conference demonstrated the strong commitment of the international community to reconstruction assistance to Afghanistan by making specific commitments and pledges. Afghan and international NGOs held a separate meeting. Experts also met to discuss military demobilization, military and police training, counter-narcotics issues and alternative development.

IV. Raising Economic Growth and Reducing Poverty: Reform of the Multilateral Development Banks

President Bush has said: "A world where some live in comfort and plenty, while half of the human race lives on less than \$2 a day is neither just, nor stable." Poverty today remains widespread and deep. About 10 million children die each year, most from preventable diseases. More than 113 million primary school age children do not attend school, with forty percent of the children in Sub-Saharan Africa out of school. Approximately 1.3 billion people lack access to adequate quantities of clean water and nearly 3 billion people are without adequate sanitation, leaving them vulnerable to disease. The HIV/AIDS epidemic continues to spread relentlessly, with over 12 million orphans aged 14 or less in Africa alone, and is rapidly reversing the hard-won development achievements of many countries. The magnitude and human consequences of the development challenge we now confront underscore the need for international development assistance efforts to do a much better job than they have been doing in increasing opportunities for people to create a decent living for themselves and their families. We can and must do better.

In my travels around the world, I have seen an untapped reservoir of human potential in all countries, including the poorest. To fully realize this potential, countries need to create an environment with the institutional conditions and incentives – including the rule of law, enforceable contracts, stable and transparent government, and a serious commitment to eliminate corruption – required to encourage individual enterprise and to provide individuals with the health, knowledge, and skills they need to participate in and contribute to economic activity. Donors and external assistance can help only if the right fundamentals (including policy environment and institutions) are in place to harness human potential. For this reason, we have worked hard with other shareholders in the multilateral development banks (MDBs) to concentrate assistance on those countries with sound economic policies and good governance practices. For example, for the IDA-13 replenishment period, 17 countries will have their IDA lending allocations significantly reduced due to poor governance ratings.

Rising productivity is the driving force behind increases in economic growth and rising per capita income. We have been pressing the MDBs to focus more intently on operations that raise productivity growth, concentrating on such operations as:

- Improving education and health;
- Promoting private enterprise, including small and medium enterprises;
- Promoting rule of law, effective public expenditure management, accountability and anti-corruption; and
- Opening economies and strengthening trade capacities and investment environments.

Mexico's homegrown PROGRESA program provides a good example of a productivity enhancing investment in children's human capital that should have enormous future dividends. The program, initiated in 1996 and supported by the MDBs, provides financial transfers to the rural poor conditional on keeping children in school and providing them with basic preventive health care and nutrition. Education grants are supporting schooling for 3.6 million poor children, and nutrition and health grants are benefiting 1.6 million children aged 0-5 years of age. It is estimated that children's educational achievement has increased by about 10 percent in the first three years of the program.

As a result of U.S. efforts, productivity is receiving more emphasis in the debate on MDB policies within the institutions and among other shareholders. We will continue working actively to ensure it becomes a hallmark of actual operations. Our goal is to raise economic growth, improve living standards, and improve economic stability in the world economy.

The scale of global poverty and unrealized human potential underscores the importance of the MDBs (and all other donors) focusing much greater attention on improving the effectiveness of their assistance. We are pressing all the MDBs to establish monitoring and evaluation systems that measure development results. In IDA-13, the U.S. is providing supplementary funding conditioned on measurable results in areas crucial to economic growth and poverty reduction. In response to a request I made of World Bank President Jim Wolfensohn in Ottawa last November, the World Bank is undertaking a study of development effectiveness and the "lessons learned" from operational successes and failures. This study will feature prominently in discussions at the upcoming Financing for Development Conference in Mexico and the G-8 Summit in Canada. Our challenge, going forward, will be to ensure that the successes and failures of the past fifty years guide and improve development efforts in the future.

Private sector development is crucial to economic growth and poverty reduction. We believe that the MDBs can play a larger role in promoting needed investment climate reform and in channeling technical assistance and project finance to fund viable private sector projects in countries that are committed to implementing policy and regulatory changes to ensure a sound investment climate.

President Bush has also proposed that up to 50 percent of the World Bank and other MDB funds for the poorest countries be provided as grants rather than as loans. This is an important part of the Administration's MDB growth agenda. Why? Because grants are the best

way to help poor countries make productive investments without saddling them with ever-larger debt burdens. Investments in crucial social sectors (e.g., health, education, water supply and sanitation) do not directly or sufficiently generate the revenue needed to service new debt.

Take, for example, IDA's effort to address the HIV/AIDS pandemic in Africa. The Multi-country AIDS Program (MAP2) is a framework arrangement providing for a series of independent IDA credits/grants with a total value of \$500 million to be committed over the next three years in Africa. Unfortunately, IDA's proposal for MAP2 would allow for only a maximum of 20 percent (or up to \$100 million) of total financing to be provided in the form of grants instead of loans. I believe such assistance should be delivered on entirely grant terms. How can we expect countries to take on additional debt to fight the scourge of HIV/AIDS? There are no revenue streams directly associated with controlling the spread of HIV/AIDS or treating its victims. Development assistance on grant terms in such cases is the only viable alternative.

This project also demonstrates the important role the World Bank has to play on critical development issues. That is why we have supported and will continue to support the World Bank as well as the other MDBs. President Bush's budget calls for an 18 percent increase in the U.S. contribution to IDA linked to improvements in IDA's performance. He has also called for an 18 percent increase in the U.S. contribution to the African Development Fund.

Unfortunately, the U.S. proposal on grants has been opposed strongly by other donors participating in the IDA-13 and African Development Fund replenishments. It is important to reach an agreement on grants that will facilitate closure on these important replenishments. The United States has demonstrated flexibility on this issue. Final agreement will depend on other donors also demonstrating commensurate flexibility.

The Administration's FY 2003 budget request of \$1,447 million for Treasury's international programs reflects our development priorities. Economic progress in the developing world is enormously important to the United States. The need to reduce extreme poverty and improve the lives of people around the world is a priority in and of itself. Because poverty and economic instability can be a breeding ground for terrorism, our fight against terrorism makes our collaborative efforts with our partners to improve the lives of the world's poor take on a new and more strategic dimension.

The Administration's request provides for:

- \$1,259.4 million to fully fund annual U.S. commitments to the MDBs;
- \$177.7 million to fund the first year of a three-year plan to clear U.S. arrears to the MDBs; and
- \$10 million for technical assistance to finance expert advisors to countries facing economic transition or security issues and for training governments' finance ministries and offices to combat terrorist financing.

This request will enable the MDBs to address critical development issues in key regions. It projects U.S. leadership, and it complements our reform efforts to strengthen the effectiveness of these institutions.

V. Promoting Global Free Trade

The global economic slowdown also brings into sharp focus the reasons why we need increased trade. The drop in U.S. trade (both exports and imports) coincided with a deceleration of U.S. growth during 2001. Trade is important to the U.S. economy, and freer trade can help stimulate growth: it fuels competition and innovation, it helps to increase productivity, and it stimulates sustained growth with low inflation. Trade has created millions of jobs that pay above-average wages, and has helped promote the global growth upon which America's own growth and prosperity ultimately depend.

Trade now accounts for about one quarter of our economy, and export growth accounted for one-fifth of U.S. economic growth during the past decade. Together, NAFTA and the Uruguay Round Agreements boosted the annual income and lowered the cost of purchases for an average American family of four by \$1,300 to \$2,000. In 2001, the United States exported more than \$1.0 trillion in goods and services, which generated about 10 cents of every dollar that we Americans earned.

The importance of trade to the U.S. economy underscores the need to restore momentum to trade liberalization. President Bush achieved a key objective in his trade agenda with the WTO Ministerial decision in Doha to launch multilateral trade negotiations. Negotiations are already underway for a Free Trade Area of the Americas (FTAA) and for Free Trade Agreements (FTAs) with Chile and Singapore. In January 2002, the United States announced that it will explore an FTA with the countries of Central America.

Trade liberalization offers the same benefits as a tax cut for the American consumer and the American exporter. And multilateral trade liberalization is a global tax cut for *all* consumers and exporters. A recent study estimates that cutting global trade barriers to goods and services by one-third would provide a boost of \$177 billion per year to the U.S. economy – equivalent to a tax cut of \$2,500 per year for the typical American family. An FTAA, the creation of which is currently being negotiated, should provide additional benefits of some \$53 billion, or about \$800 per year for the average American family. When combined with existing free trade agreements, an FTAA, as well as bilateral FTAs with Chile and Singapore, will fully open market access overseas for nearly 50 percent of U.S. exports.

Let me say a few words about trade in financial services, specifically. I view the liberalization of trade in financial services as another powerful instrument for accomplishing our international economic policy goals. True, we have made great strides in liberalizing trade in financial services over the past decade, but I believe we can do more – much more.

In the same way we are approaching other activities under my watch at Treasury, we are approaching trade in financial services from a goal-oriented perspective. We are asking

ourselves where to concentrate our time and resources and where our efforts will truly make a difference. The growth potential in many countries is being held back by a lack of deep and liquid capital markets. For example, this potential cannot be reached when there is no secondary mortgage market, when the cost of capital is so high that it is out of reach for all but the largest companies, or when there are few if any safe markets to invest for retirement.

The swift removal of barriers in key markets will help strengthen financial systems internationally and help translate domestic savings into investment in emerging markets. Most of all, it will help enhance economic growth and stability. Freer trade in financial services will mean more American jobs in a sector with above-average wages.

I applaud the House of Representatives for approving Trade Promotion Authority (TPA). You have done a great service to our economy. It is now imperative that the Senate acts quickly and follows suit so the Congress can approve a final version of TPA and send it to the President for his signature. Without question, TPA will be a great confidence-builder for the U.S. and the global economy.

VI. Combating the Financing of Terrorism

The war against terrorism is a new kind of war being fought on many fronts. Nowhere is this truer than in the fight against terrorist financing. The President has directed me to take all measures necessary to deprive terrorists of funds. I would like to take this opportunity to share with you some of the highlights of this battlefield.

One September 23, 2001, President Bush issued an Executive order listing 27 terrorist organizations and individuals and directing the blocking of their property. This Executive order has now been extended to a total of 189 individuals and entities. To date, all but a handful of countries have committed to join this effort; 150 countries and jurisdictions now have blocking orders on terrorist assets in force; and over \$104 million in terrorist assets has been frozen globally since September 11, some \$34 million here in the United States, and another \$70 million by other countries or jurisdictions. A portion of that amount linked to the Taliban has recently been unblocked for use by the new Afghan Interim Authority.

I emphasize our reliance on other countries because that is one of the most salient features of this front of our war. Allies have been, and remain, critical to our military efforts. On the financial front, they are absolutely indispensable. No matter how smart our bombs are, they can't destroy a bank account in a foreign jurisdiction. Blocking terrorists' access to the international financial system requires an international coalition, all working together. We will work with every nation around the globe to ensure that there is no safe haven for terrorist money.

The actions taken against the Somali-based hawaladar, Al-Barakaat, exemplify how efforts both domestically and abroad can lead to success in this war on terrorist financing. Al-Barakaat used its offices in the United States and in 40 countries to finance and support terrorists around the world. Treasury and the FBI took decisive law enforcement and blocking actions against Al-Barakaat. On November 7, 2001, federal agents executed search warrants in three

cities across the country (Boston, Columbus, and Alexandria) and closed eight Al-Barakaat offices in the U.S.

In conjunction with our domestic efforts, our allies closed down Al-Barakaat offices and blocked its accounts in European countries as well. However, the key to shutting down that network and stopping the estimated \$15-20 million that was flowing annually from it to Al-Qaeda was the action taken by the UAE in freezing the account of Al-Barakaat corporate headquarters. Not only was that the lion's share of the resources frozen that day, but it also meant that this conduit, which had served Al-Qaeda so well, was closed.

It is vital that we continue to build this coalition and coordinate with our international partners. We have spoken to finance officials in nearly 100 countries, and have advanced this agenda in multilateral forums. In order to measure progress, our Task Force on Terrorist Financing at Treasury is keeping track, account by account, dollar by dollar, of all countries' efforts. We have also had success pursuing international cooperation to combat terrorist financing on a global scale through a number of forums including the U.N., the G-7, the G-8, the G-20, the Financial Action Task Force (FATF), and the international financial institutions. In late October 2001, the United States hosted an Extraordinary FATF Plenary session, at which FATF members established eight Special Recommendations on Terrorist Financing. These recommendations quickly became the international standard for steps that countries can take to protect their financial systems from abuse by terrorist financiers.

Three weeks ago, the G-7 group of industrial countries met in Ottawa and agreed to an ambitious new work program. In particular, the G-7 agreed to develop a mechanism to jointly identify terrorists whose assets would be subject to freezing. This will require even closer cooperation and commitment. We will also develop key principles regarding information to be shared, the procedures for sharing it, and the protection of sensitive information.

Beginning on March 4, I will make a four-day visit to Kuwait, the United Arab Emirates (UAE), Bahrain, and Saudi Arabia. This visit will provide an opportunity to recognize the contributions made by Gulf countries to the international effort to combat terrorist financing. I hope to secure commitments from the host countries to take further concrete steps, some of them jointly with the United States, to deny terrorists the money they need to operate.

Ultimately, implementation and enforcement are the critical factors of success. The Congress and this Committee have been exceptionally helpful in giving us the statutory tools we need. In particular, Title III of the USA PATRIOT Act – the International Money Laundering Abatement and Anti-Terrorist Financing Act of 2001 – has strengthened our hand considerably against those who would harm the United States and its citizens. I thank you, and assure you that we will not let these tools get rusty.

VII. Promoting Cooperation and Coordination on International Tax Matters

International cooperation and coordination on tax matters are critically important for reducing investment distortions and for promoting the proper functioning of financial markets and systems. Tax rules should not serve as an artificial barrier to cross-border investment. That is an issue not just with respect to our own tax rules, but with respect to the interaction between our tax rules and those of our trading partners, which is why we address these issues through international agreements.

The United States has an extensive network of bilateral income tax treaties covering approximately 60 countries. The purpose of those treaties is both to coordinate our respective income tax systems so as to avoid double taxation and to reduce or eliminate tax “toll charges” on cross-border investment. We currently are working to update and modernize our existing tax treaties with our major trading partners. At the same time, we are working to expand our treaty network to cover trading partners with which we do not currently have a tax treaty relationship.

It also is critically important to establish and maintain the international relationships necessary to assist us in enforcing our tax laws. As I have said many times, we have an absolute obligation to enforce the tax laws of the United States, because failing to do so undermines the confidence of honest taxpayers in the fairness of our tax system. While we do everything we can ourselves to address the evasion of U.S. taxes, given the increasingly global nature of economic activities, we can be more effective with the cooperation of other countries.

To this end, we need to be able to obtain information from another country when we have reason to believe that a taxpayer is using the institutions of that country to evade U.S. taxes. Currently, we have effective tax information exchange arrangements with many of the world’s financial centers. However, some significant financial centers have yet to enter into such an arrangement with the United States, and some of our existing arrangements do not provide for the exchange of information for all U.S. tax matters.

We will continue to work aggressively to expand and improve our tax information exchange relationships, with a particular focus on significant financial centers. I am very pleased to inform the Committee that, in furtherance of my commitment before Congress last year to produce results in this area, the United States has recently signed tax information exchange agreements with three significant jurisdictions in the Caribbean – the Cayman Islands, Antigua and Barbuda, and the Bahamas. We are in ongoing discussions with several other jurisdictions to expand further the reach of our information exchange relationships with them. We must act effectively to ensure that financial institutions are not used for cheating on U.S. taxes.

VIII. Concluding Remarks

I greatly appreciate the opportunity you have given me to present our first year achievements, ongoing efforts, and future goals on international economic issues. There is one final point I would like to make. I am determined to enable the Treasury Department to fulfill its

mission to develop and implement our international economic policy. Currently, the Administration executes a large number of legislative mandates relating to U.S. participation in the international financial institutions, including requirements for directed voting, policy advocacy, certifications, notifications, and reports, that have built up over time. The U.S. Government's policy development and implementation in the IMF and the MDBs would be improved by a consolidation of these mandates. Some mandates go back 50 years. Some provisions overlap, or are inconsistent. There are 32 directed vote mandates and over 100 policy mandates, plus numerous reports, certifications, and notifications. I want the Congress to be fully informed, but numerous vestigial reporting requirements have increased the amount of time senior officials spend working on these reports to levels that warrant serious concern. I would like to work with you to rationalize and focus our mandated requirements and reports.

I look forward to continuing to work with this Committee and the rest of the Congress on our shared goal of increasing prosperity at home and abroad. Thank you, and I look forward to answering any questions that you might have.